DOW THEORY LETTERS INC.

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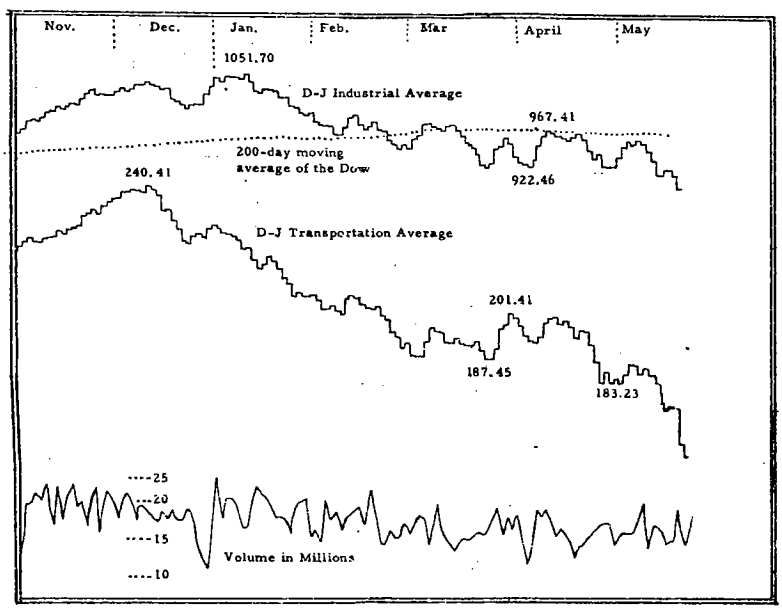
May 11, DJIA 927.98, PTI 804, A-D ratio -10.90
May 18, DJIA 895.17, PTI 773, A-D ratio -12.74

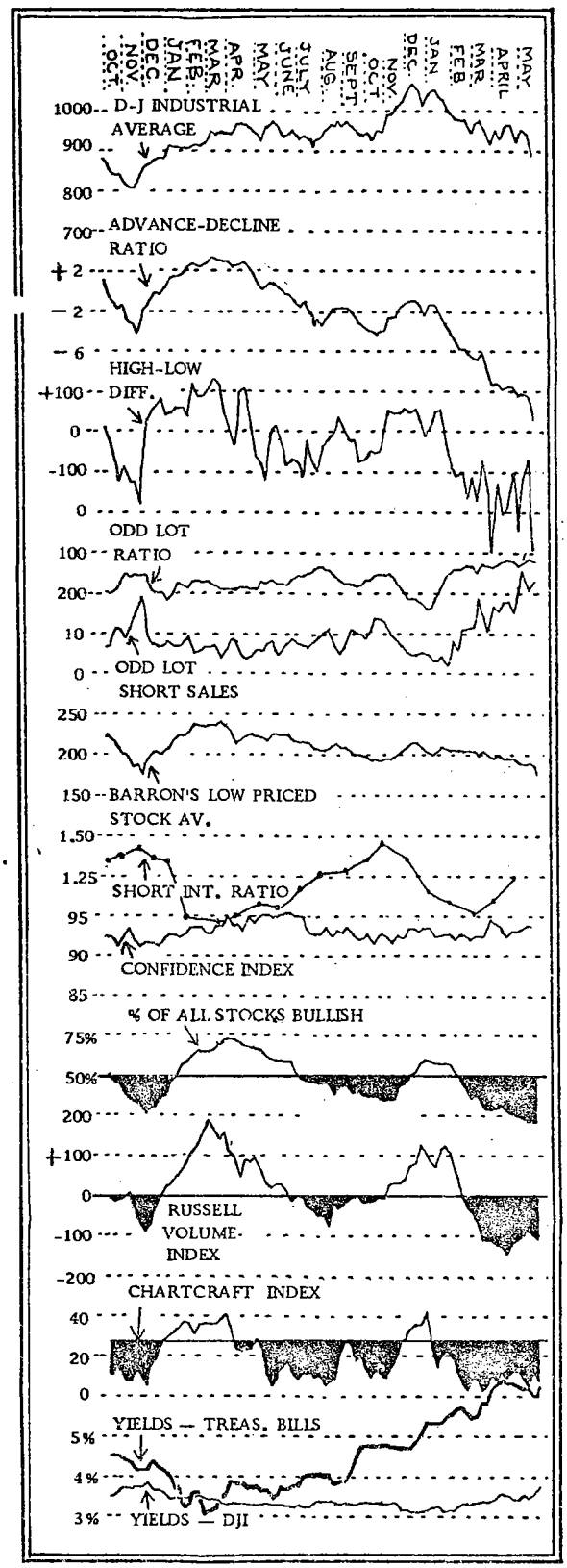
HERE GOES: For some reason, I have recently been flooded with new trial and regular subscribers. I feel I owe them a few explanations. First, I have agreed to send out 36 Letters a year for $75 (which is a low price, by comparison with most other investment services). But I cannot, in most cases, accept personal telephone calls from subscribers. Each call requires five or ten mimutes, and each call takes my mind off what I am studying or writing for all other subscribers. My readers number in the thousands, and it simply isn't fair to burn up my energy on one subscriber's personal problems — at the cost of these reports which go to all subscribers.

I obviously have to assume some kind of intelligent position. My position is that personal advice is beyond my scope. And frankly, I have never thought much of "personal advice" anyway (including my own). What I try to do is teach people to think for themselves and act for themselves. My opinions and and studies are offered as an aid in this pursuit.

Second, I beg all correspondents, if you possibly can to use a typewriter. The bane of my life is trying to read undecipherable letters. I am not able to answer most of the dozens of letters which arrive here each week, but I do love to read them — and I appreciate the many news clips, graphs, etc. which are included. These letters from all parts of the world provide me with "a thousand eyes," and I don't know what I'd do without them. So if I don't answer, do not think I don't love you...because I do appreciate those letters.

Third, I send out a six-page report every ten days. I try to include as much information as possible, and I try not to subject readers to too many tedious studies (if a "tough" or mind-bending study is included, it means that I feel it is vital that you understand this particular piece of information).





 I like to up-date various previous studies, but I don't want to have to repeat the full explanation for each one. This means, you must save back-Letters (that's why I go to the expense of punching holes in the mailings). Please, get your wife, husband, mother, paramour or butler to make a simple three-ring file of the reports for you. I consider this crucial.

Last, I hereby announce that I do not "hold any information back," I tell as much in these Letters as I know. When I think the time has arrived to sell our gold shares, I will say so. When I think the time is ripe for buying common stocks in general, I'll bore you to death with study after study regarding why stocks are a great buy. When I think the current primary bear market is over and a new primary bull market is about to be born, I will shout it to all subscribers. I even have a little picture of a bull cut out and ready. I hope to paste it on page 1 sometime during the next year or so. In the meantime, I am showing the animal at right. He appears in honor of all those who have ignored what I have written over the last few years. He didn't want to see the bear. He never purchased gold shares. And doubtless, when the bull arrives, he will still have his head in the sand.

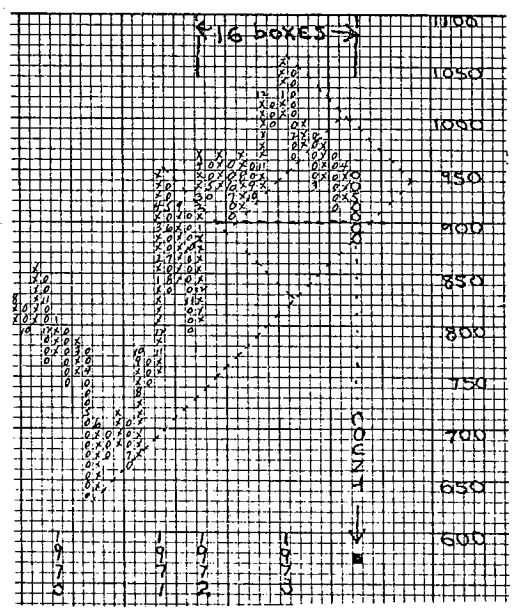
MARKET: On May 14 the Dow Industrials dropped 18.29 points to close under their July 20, 1972, low of 910.45. This penetration confirms the much earlier Transport smashing of their own 1972 low (recorded October 20) of 212.24. The May 14 Industrial penetration reconfirms the fact that a primary bear market has been in existence. Doubtless, many critics of Dow's Theory will complain that "the signal came late." I will repeat again that nothing in the writing of Dow, Hamilton or Rhea (or my own, for that matter) ever, ever suggested that one wait for a bear signal before "cleaning out" in a bear market. I have used an almost endless series of indices and studies in my effort to get subscribers out of common stocks and into cash (i.e., Treasury bills, certificates of deposit, bankers' acceptances, bank savings) or gold shares. The May 14 bearish signal merely reconfirms what we already knew, namely, that we have been in a primary bear market, and one might as well play "patty-cake" with a grizzly as beat a primary bear market with common shares.

Suddenly, everyone wants me to tell them "what the market is going to do from here." This gives me the choice of trying to play "genius" or simply being honest. I prefer the latter. So my answer is that over the near term, I haven't (as usual) any crystal-ball answer as to what the market is going to do (and the discouraging truth is that no one else does either, including your favorite market soothsayer).

Over the longer term, I most definitely do have an idea of what the market will do, and my answer is that the Dow is going to smash below the 631.16 low of 1970. This primary bear market did not end at the 1970 low, and by definition the continuing bear market will take the Dow Industrials below the 1970 low of 631.16 before the forces of correction, contraction and ultimate severe deflation breathe their last (yes, I said deflation — that's what happens after inflation).

At this juncture, I want to review the long-term point & figure chart. I have written about the mysterious "count" or measuring potential of the P & F charts before, and I include a P & F chart of the Dow (chart courtesy of Chartcraft, Larchmont, NY 10538). Here we see a 10-point, 30-point reversal chart. This means that every box on the chart equals 10 points and only rallies or declines of a full 30 points or more show on this chart. All rallies are depicted by vertical rows of X's, declines are shown by vertical rows of O's.

Dow Jones Industrial Average
Postings 11, 12, 1, 2 and close



The 1972-73 formation as seen on the chart is a "head-and-shoulders' top measuring 16 boxes across. Since each box is 10 points, and since it requires 30 points for a reversal, we multiply 30 by 16 to obtain the "downside count" from the peak (the peak was 1060 on the Dow). So 30 times 16 is 480 and subtracting 480 from 1060 we get a P & F "horizontal count" of 580. This is below the 631.16 Dow low of 1970, and it is a figure which fits into my concept of "where the Dow could ultimately go" before this bear market breathes its last.

Note that the long-term trendline from the 1970 low meets the Dow at 890. A Dow closing at 880 or below would decisively violate the rising trendline, and this means that 880 constitutes a good "benchmark" for the Dow on any decline from here. Breaking 880, I would say that there would be little resistance for Industrials between here and the 1970 low.

The indicators (or measuring devices) which we watch are providing an insight into the utter devastation which has overtaken Wall Street. A glance at any stock chart book (such as the outstanding Crosschart volume published by Jim Dines, 18 E. 41 St., NYC 10017) shows broadscale collapses in countless issues throughout every area of the market. In many cases, declines have taken individual issues back to levels of 10, 20 and even 30 years ago!

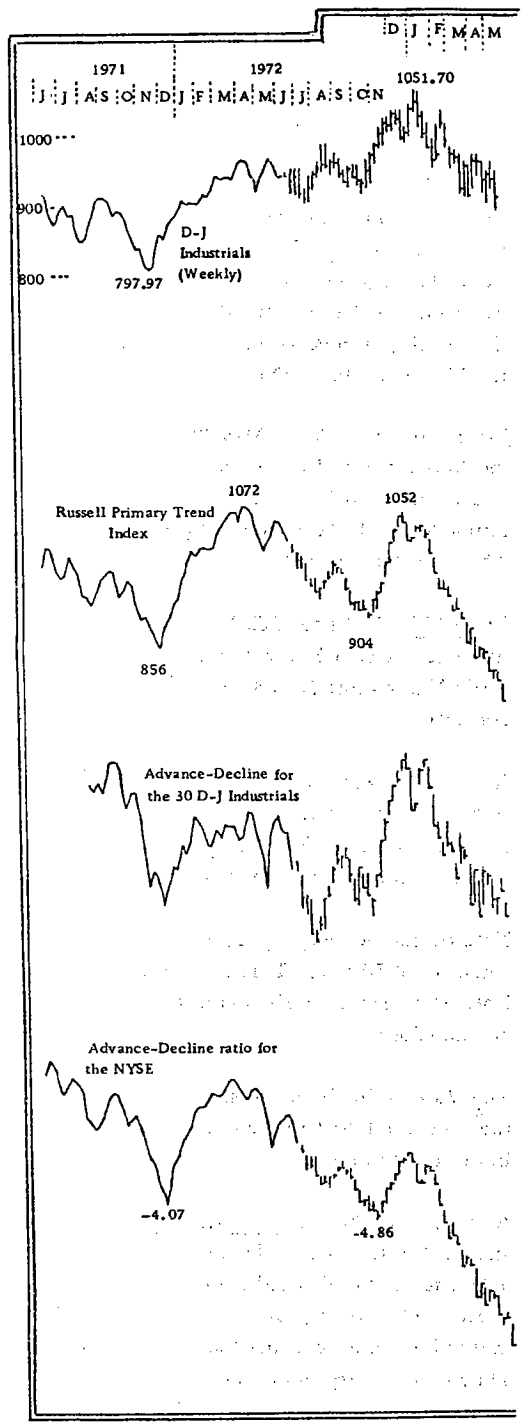
Those who chart the page one PTI and A-D ratio figures (as I have asked all subscribers to do) will note that both of these indicators have caved in, thus widening the "vacuum" which has been building under the Dow. The accompanying chart shows the weekly range of these two critical indicators together with the Dow and the A-D index for the 30 Dow stocks.

Last week the Dow found the crashing market picture too much for it, and the giant "head-and-shoulders" pattern in Industrials began its resolution to the downside. The week ended with the Dow battering the 900 level.

The Primary Trend Index (PTI), made up of the three D-J Averages, the S & P 500 Average, the A-D ratio, the daily high-low plurality, the 40-Bond Average and the daily most-active-stock plurality, smashed through its 1971 low on April 23 (see Letter 562, page 1). That ominous technical signal has been followed by a further sickening collapse in the PTI, my own index which measures the broad, technical condition of the market.

The A-D index of the 30 Dow Industrials, having "consolidated" for the past 9 weeks, is finally breaking out on the downside, thus confirming the increasing weakness in the Dow itself.

Finally, the A-D ratio (which gauges the advancing or declining tendencies of the majority of NYSE issues) has headed south with a surge which is extraordinary in its intensity and relentlessness. In my opinion, the indicators shown on this chart should not be "written off" as chart squiggles pointing to a market which is simply undergoing a healthy correction. Rather, the downside smashes seen on this chart provide a preview of the general economic situation as it will be six months or a year from now. If my interpretations are correct, the business scene in late-1973 and 1974 will not be a pretty sight.



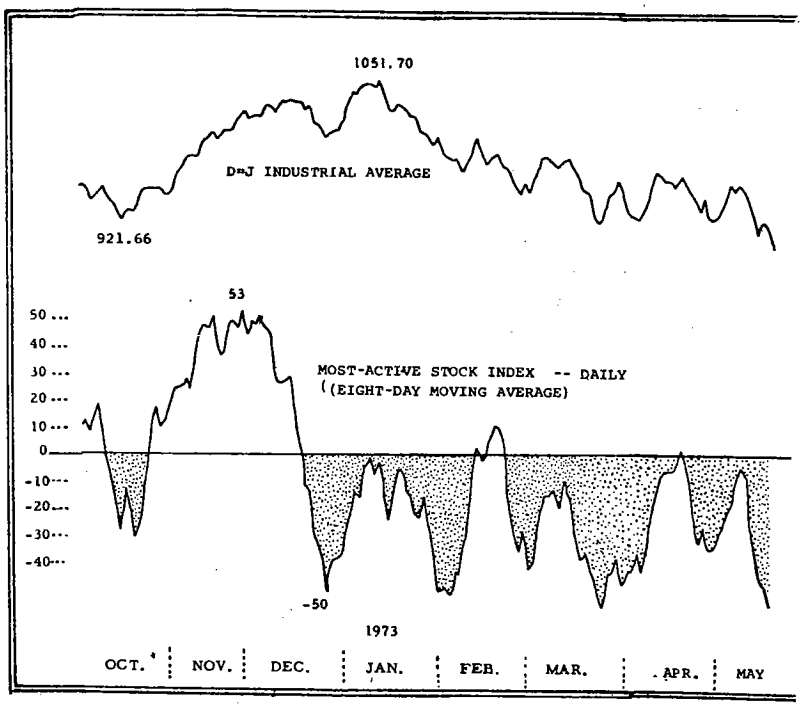
MOST-ACTIVE STOCKS: I have commented a number of times about the daily most-active stock indicator (see Letter 558). This index (see page 4) has proved to be one of "the heroes" of 1973, and I want to review it again. First, it should be understood that the "most-active stocks" comprise about 15% to 30% of daily NYSE volume. This list of the 15 most-active stocks is published daily in most newspapers. The most-actives tend to indicate the direction of big money, and big money usually moves before the rest of the market. It follows, then, that the direction of the most-active index tends to lead the general market.

The most-active index (MAS) is constructed as follows. I take the plurality of advances or declines each day, and put the resultant figure on an 8-day moving average. For instance, if on a given day 9 stocks advanced and 3 declined (3 unchanged), the plurality reading is plus six. This constitutes the day's addition to the 8-day moving average.

I have shown the MAS together with the Dow for the period of the last eight months. Note that MAS hit a late-November peak of plus 53. This "predicted" the January surge which took the Dow to its all-time high of 1051.70. But even before the record Dow reading, MAS dove to the minus side, hitting a minus 50 in late-December. The minus 50 forecast could not have been more accurate.

The Dow turned down in January and never stopped sinking. But it is the performance of MAS during 1973 that is so fascinating and instructive. The fact is that MAS's 1973 action is some of the worst on record. MAS moved to the plus side for exactly 3 days in late-February and that was the full extent of the plus readings for 1973! Never has an indicator sounded a more persistent and a louder series of warnings. The message was clear and as of this reading it still is. This market is under distribution, the "big money and volume action" is on the downside. It has remained that way for the past six months, a massive period of unrelenting liquidation on the NYSE.

Just for the record, on May 18 MAS hit minus 74, the lowest figure I have ever recorded for the daily figures on an 8-day moving average. This corresponded with the Dow finally plunging under the 900 mark for the first time since January 27, 1972.



STUMBLE: In Letter 562 I presented the chart of the Dow Industrials and the much broader (unweighted) Value-Line Industrial Average. Under Elliot Principle terms, I showed how the Dow Average was undergoing a milder "flat" bear market correction while Value-Line (which includes most of the non-Dow NYSE issues) is undergoing a much more drastic zig-zag bear market correction.

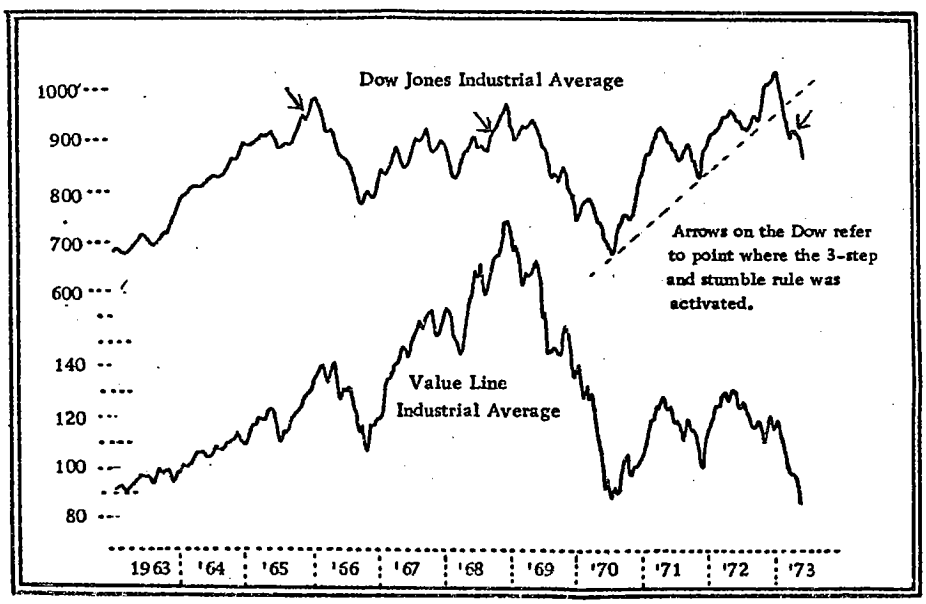
If my Elliot analyses work out, the ultimate bear market bottom for the Dow will be under the 1970 low of 631.16, perhaps in the 400 to 600 area. But the vast majority of NYSE (non-Dow) issues will be subject to brutal bear market collapses, and showed in Letter 562 that most stocks are already in the throes of massive declines (i.e., Arlans Dept. Stores, Pan-American World Airways, J.P. Stevens, etc.).

Note on the accompanying up-dated chart that the Dow has now decisively broken its upward trend, the trend that has held since the 1970 low. This could mark the beginning of the final, long downward phase of the bear market which began in 1966. Note also that the Value-Line Industrial Average has actually broken below its own 1970 low, a move which has the most bearish connotations.

The Value-Line break should be part of a major downward movement which in extent could equal (starting from the 1972 peak) the previous 1968 to 1970 collapse on the Value-Line Average. Another such cave-in, needless to say, would leave Wall Street in utter shambles.

A few weeks ago the Wall Street Journal (Dan Dorfman's column) included a piece on Mr. Edson Gould's "three-step and stumble" rule. This rule refers to the activities of the Federal Reserve Board. The Board possesses three methods of manipulating fiscal policy. They can (1) vary stock margins, (2) vary the bank discount rate, (3) vary the member bank reserve requirements.

According to Gould's thesis, anytime the Board increases any of these categories three times in a row (it must be in one category, however, not a combination of two or three) the three-step and stumble rule is in effect. On April 20 the Reserve Board increased the discount rate for the third time, thus activating the three-step rule.



What happens next? There are 9 instances of the three-step rule since 1913. In all cases the Dow declined, with the average of the 9 declines being 30.1%. There is usually a 3-4 month lag, following the activation of the rule, before the real market decline begins. But the lag is by no means a certainty. The average rally (prior to the major decline) has been 8.5%, so if we do get the "normal" rally we could expect the Dow to rise to move over 1000 again before it goes into its "average" plunge of 30.1%. If the Dow is to decline by an average 30.1% (starting from 963.20, the April 19, 1973, price, which was recorded the day before the three-step rule was activated), we could expect a slide to 673. On April 10, as if to eliminate all doubts regarding their intent, the Fed boosted the discount rate for the fourth time, to 6%, highest level since the 1969-70 credit crunch and the highest since 1921.

I have included at right the actual record of the three-step rule, and subscribers can study this for themselves. I have also placed arrows on the Dow Industrials (see chart) showing where the 1965, 1968 and the latest or 1973 three-step signals occurred.

So there it is, I've given the warning, Gould's three-step and stumble rule has given the warning, my Elliot studies have given a warning, Value-Line's Average has given the warning. Let history be the judge.

Here is a rundown of what happened the last nine times the three-step rule was activated; figures relate to Dow Jones Industrial average:

Rate	Date activated	Previous day close	subsequent low	% decline
Discount	11- 3-1919	118.63	63.90	46.14
Discount	7-13-1928	206.71	41.22	80.06
Reserve Req.	5- 1-1937	174.27	92.92	46.68
Margin Req.	1- 1-1946	192.91	164.20	14.88
Discount	8-13-1948	179.63	161.86	9.89
Discount	9- 9-1955	475.06	419.79	11.63
Discount	3-31-1959	602.65	536.77	10.93
Discount	12- 6-1965	946.10	754.51	20.25
Discount	4-10-1968	909.21	631.16	30.58

* * *

The May 21 issue of Barron's shows that the percentage of customers' equity under 40% (the danger line) has climbed to 19% on the NYSE, highest in history. Thus, the whole margin situation is becoming increasingly perilous, and it would not surprise me to see massive "calls" during the weeks and months ahead.

The Dow Theory bear signal article in this same issue of Barron's should be ignored. The writer, though sincere, makes no mention of phases (bear signals are only valid when given during the third psychological phase of a bear market). Secondly, the writer of the article does not realize that following lows, it requires rallies in both Averages of full secondary proportions before the smashing of the previous lows can be labeled as a "primary bear signal." The Barron's writer calls a bear signal following a tiny Transport rally lasting only four (!) days and a miniscule Industrial rally and a subsequent breaking of the prerally lows. He also, for some strange reason, talks about rallies of 3% or more as being significant, whereas there isn't a thing in Dow's Theory which points to the importance of a 3% rally (I wonder where he dug up the 3% figure?). Ironically, the article happens to be right but for the wrong reasons (we are in a bear market, but not for the reasons stated). In Letter 557 I presented a correct Dow Theory interpretation, stating that the 1972 Transport low of 212.24 and the 1972 Industrial low of 910.45 were the primary bear points. So I must ask subscribers to skip the Dow Theory piece in my beloved Barron's; it's just plain wrong.

Speaking of the Dow Theory, there is an ad on page 32 of the same (current) issue of Barron's entitled "The Dow Theory Can Make You Rich." Well, so can holding up banks. But don't bet on it. The ad talks about the Dow Theory "language" of "blow-offs, coils, falling wedges, flat-top ascending triangles." For the record, this is not the language of Dow Theory, and if Robert Barnes, author of the book, thinks it is, then he knows nothing of Dow's Theory. I have no idea what theory Mr. Barnes is writing about, but it isn't Dow's Theory. Furthermore, Robert Rhea (probably the greatest Dow Theorist in history) repeatedly stated that Dow's Theory is not a system "to beat the market." Rhea would turn in his grave if he read the page 32 Barron's ad.

I have included this little tabulation from Arthur Lipper, just in case you are still not convinced that common stocks are the road to disaster during a bear market. You can beat a bear market for awhile, if you're lucky — but sooner or later the bear will maul you, and that is what the fund managers (I call them the "super odd-lotters") are finding out.

Following are Arthur Lipper & Co. mutual fund indexes, including reinvestment of all distributions, for the week:

No. & Type of Fund	Per Cent Change Year to May 17	Week of May 17
534 All Funds	—18.38	—4.01
335 Growth	—22.89	—4.82
106 Growth & Income	—13.66	—3.38
22 Balanced	—10.13	—2.54
66 Income	— 5.61	—1.44
5 Bank & Insurance	—21.31	—3.68
Dow Industrial 911.72	—10.62	—2.93
S & P 500 105.56	—10.58	—3.63
S & P 425 117.99	—10.53	—3.74
N.Y.S.E. Com. 55.96	—13.21	—3.77
Amex Index 23.08	—12.44	—2.29

STOCKS AND THOUGHTS: On Friday, May 19, as 560 Big Board stocks hit new 1973 lows I thought to myself, "The only Wall Street area in worse shape than the market itself is the investment advisory area." As I read the many dozens of reports which flocked in over the weekend, I felt a sense of embarrassment. With exceptions, of course, such as Janeway, Schaefer, Schultz, Holt, Zweig and a handful of others, the writing was a mixture of unreality, wishes, apologies and for want of a better word — sheer confusion.

There is no question about it. The collapse of the stock market has caught (as it usually does) the vast majority of the investment fraternity by complete surprise. In many cases, bullish promises and forecasts have not even been hedged (a humility which should never be overlooked). I note that many of the newcomers to Wall Street letter writing are included in the ranks of the crucified. But in this business, absolute certainty and arrogance are simply one's ticket to the "Baptism of Fire." At

present, the fire has become an inferno, and if it results in anybody learning anything, perhaps (as in Watergate) it will be worth it.

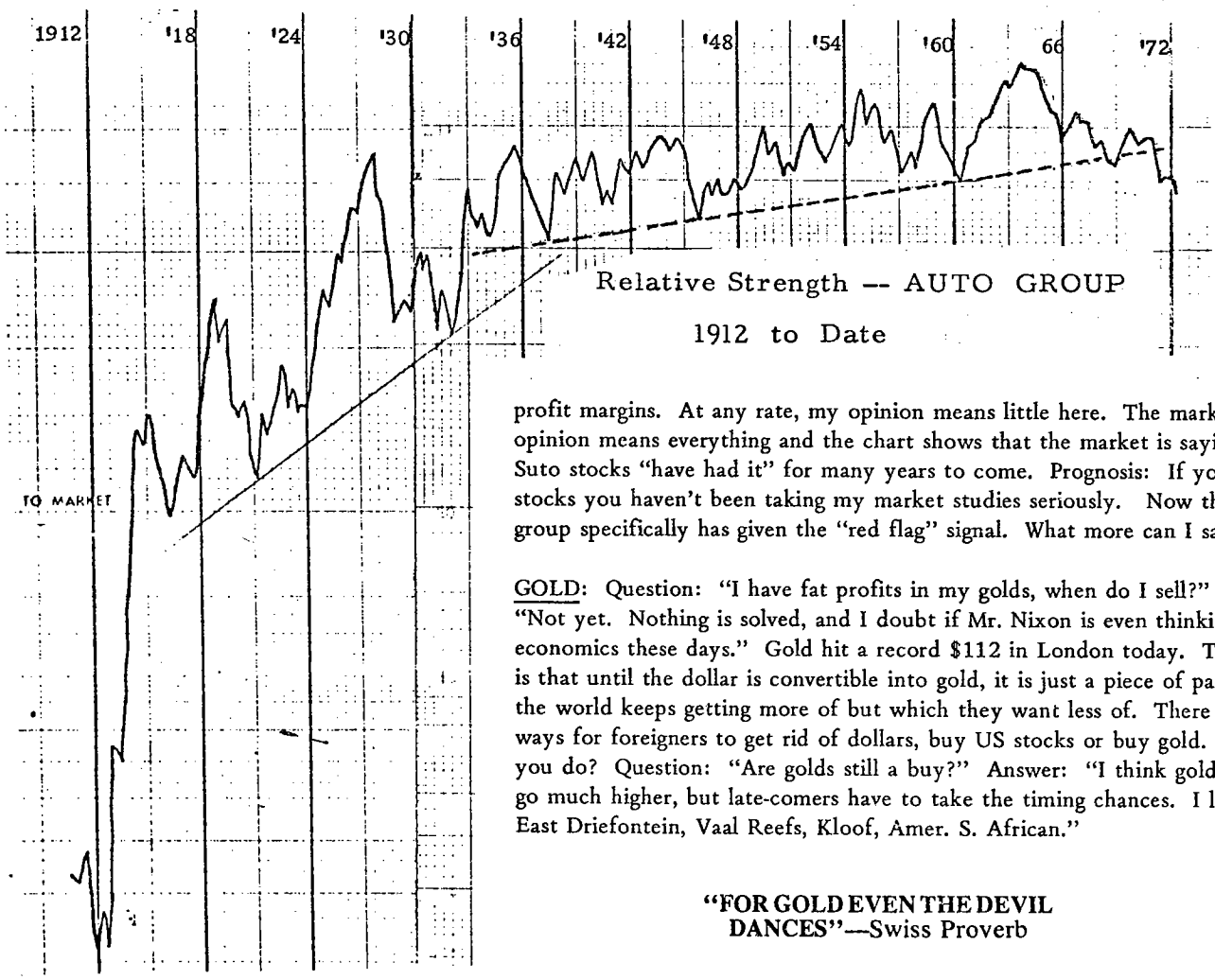
Some of the most intelligent things said last week stemmed from the dagger-like pen of my friend, Elliot Janeway, and I want to quote just a sentence or two: "On my theory that stock prices capitalize dividends and not earnings, stocks selling at 5 to 8 times earnings and yielding 3 to 4% are not cheap. Their earnings will come down before their dividends go up...The End of the Boom is being signaled now — and no longer just inside the US. The boom is riding for a fall around the world...beginning in America, this autumn. One by-product of this will be to clear up the mystery of why stocks are selling so low relative to current earnings." I offer Janeway's quotes so that newer subscribers may see that there are some analysts who can cut through the fog — to the truth.

STOCKS: This remarkable long-range chart should probably be labeled "chart of the year." It traces the relative strength of the Auto group (compared with the S & P425) over the past 60 years (chart courtesy of Ray * Signals, 43 Lake Ave., Montrose, PA 18801). I believe this chart is depicting a "turn" of historical proportions in Autos, comparable, for instance, to the decline in Steels which began in 1960.

Note that the relative strength (RS) of the Autos rocketed up during 1912 to 1918, as this dynamic new industry captured the imagination of the world. Then from 1918 to the mid-1930's (note steep rising trendline) the Auto industry embarked on a long period of growth and superior stock market performance. From 1933 to 1972 the Auto group still continued to perform better than the market, as seen by the long (dashed) up-slanting trendline. In other words, from 1912 to 1972 the Auto group was able consistently to outperform the broad averages on a trend basis.

But this year the major rising trend in relative strength has been violently reversed to the downside. For the first time in 60 years the Autos turned down on a long-term relative strength basis. I consider the 1973 break to be a move of utmost importance.

Many things are now militating against the massive US Auto industry. There is the vicious foreign competition, the pollution problem, rising costs, coming labor negotiations, the congestion problem, and the fuel crisis with its higher cost for fuels and possible rationing. The latter could necessitate total (and expensive) retooling to smaller cars and engines and with it lower



Relative Strength — AUTO GROUP

1912 to Date

profit margins. At any rate, my opinion means little here. The market's opinion means everything and the chart shows that the market is saying that the Suto stocks "have had it" for many years to come. Prognosis: If you still hold stocks you haven't been taking my market studies seriously. Now the Auto group specifically has given the "red flag" signal. What more can I say?

GOLD: Question: "I have fat profits in my golds, when do I sell?" Answer: "Not yet. Nothing is solved, and I doubt if Mr. Nixon is even thinking about economics these days." Gold hit a record $112 in London today. The problem is that until the dollar is convertible into gold, it is just a piece of paper which the world keeps getting more of but which they want less of. There are two ways for foreigners to get rid of dollars, buy US stocks or buy gold. Which would you do? Question: "Are golds still a buy?" Answer: "I think gold shares will go much higher, but late-comers have to take the timing chances. I like East Driefontein, Vaal Reefs, Kloof, Amer. S. African."

"FOR GOLD EVEN THE DEVIL DANCES"—Swiss Proverb